

13 September 2012

Kelington Group

Still uniquely strong

We were at Kelington's analyst briefing yesterday where the company's management was eager, and at pain as well (given the current negative sentiment on the tech sector and any tech-job related companies), to explain that the company's projects are actually quite diversified and thus should be able to withstand the current softness in the global economy. Management guided that 2HFY12 would be better than 1HFY12 as the latter is normally affected by the winter and festive seasons. We share management's upbeat view on the strength of the company's niche business, although we are only cautiously optimistic as the typical duration of its projects of around six months only does limit the long term visibility of its earnings. We have tweaked our FY13E earnings higher to RM10.5m (from RM9.4m previously), while introducing FY14E earnings at RM11.1m to reflect a higher win rate on its current tender book of RM400m. Accordingly, our Target Price (TP) has also been raised to RM0.53 (RM0.47 previously) based on an unchanged 8.0X forward PER pegged to its higher FY13E EPS of 6.57 sen. In line with our earnings upgrade above, we have raised our rating on Kelington to a **MARKET PERFORM** (from **UNDERPERFORM**) given the potential 8% upside (capital gain of 2.9% and dividend yield of 5.1%) of the share price to our new TP.

Diversification strength, niche premium. The main reason underpinning management's optimism is that the group is actually a specialised engineering service provider in Ultra High Purity Gas for various niche industries and sectors (such as semiconductors, electronics, solar, etc.) and in different countries, which thus minimise the risk of a weakness or fallout in any one of them impacting the company's earnings too much. For example, its lower-margin projects in China and Taiwan are being offset by the higher margins of its Malaysia and Singapore's projects. In addition, Kelington is breaking into new markets all the time (which reinforces its diversification advantage again above), with its latest new markets, Bioscience and Wind Turbine making up already about RM181m of its total current tender book of RM400m.

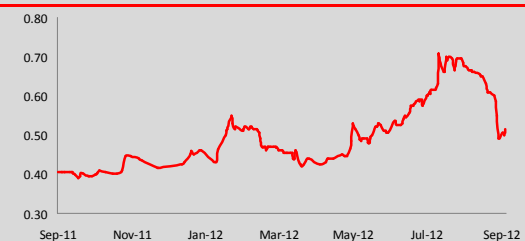
2HFY12 to be stronger. Kelington's 1HFY12 result was lower, but this was due to seasonality factors only. Normally, the 1H of the year contributes a lower revenue (30%-40%) compared to the 2H (60%-70%) due to the winter and festive seasons in the 1H. In addition to that, the 1HFY12 result was affected by the delay in one of its projects from Infineon Malaysia (a Germany-based company) due to the Eurozone crisis. However, management informs that the project will kick off soon in the next few months, which will boost FY13 earnings.

Tender book is promising. The group is currently tendering for jobs from well-known MNC and new markets with a worth of RM400m. The win rate historically has been around 20%-25%, with the projects secured usually lasting 3-6 months. Traditionally, the group has provided its engineering services to LCD and Wafer plants. For instance, the group is tendering for Samsung China's LCD plant job worth RM6m and Infineon Malaysia's wafer plant job worth RM40m. However, the group had and will continue its strategy of expanding into new markets such as Bioscience and Wind Turbine market. We are encouraged by this as it will help to diversify further the company's earnings risk. We have assumed tender book amounts of RM400m yearly for FY13-FY14 with a win rate of 20%. At this rate, we expect Kelington to maintain FY13E-FY14E earnings growth rates of 8% per annum, justifying our 8.0x PER valuation (PEG ratio of 1.0x).

MARKET PERFORM ↑

Price: RM0.515
Target Price: RM0.530 ↑

Share Price Performance



KLCI	1,647.11
YTD KLCI chg	7.6%
YTD stock price chg	14.4%

Stock Information

Bloomberg Ticker	KGRB MK Equity
Market Cap (RM m)	82.2
Issued shares	159.6
52-week range (H)	0.73
52-week range (L)	0.39
3-mth avg daily vol:	260,541
Free Float	29%
Beta	0.6

Major Shareholders

PALACE STAR	46.5%
LTAT	12.5%
SKY WALKER GROUP	12.1%

Summary Earnings Table

FYE Dec (RM m)	2011A	2012E	2013E
Turnover	139.6	135.6	146.9
EBIT	11.0	9.4	12.9
PBT	9.8	8.3	11.6
Net Profit (NP)	8.7	7.4	10.5
Core Net Profit	8.7	7.4	10.5
Consensus (NP)	-	10.5	12.2
Earnings Revision	-	-	11.7%
Core EPS (sen)	5.5	4.7	6.6
Core EPS growth (%)	2.1	-2.9	18.2
GDPS (sen)	2.0	1.9	2.6
NTA/Share (RM)	0.3	0.3	0.4
Core PER	9.4	11.0	7.8
Price/NTA (x)	1.6	1.3	1.2
Gearing (%)	44.6	63.6	65.9
Dividend Yield (%)	3.9	3.6	5.1

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Income Statement

FY Dec (RM m)	2010A	2011A	2012E	2013E	2014E
Revenue	84.5	139.6	135.6	146.9	158.6
EBITDA	9.6	11.0	9.4	12.9	13.7
Depreciation	0.9	1.1	1.1	1.2	1.2
Operating Profit	8.7	9.9	8.3	11.7	12.5
Other Income	0.0	0.0	0.0	0.0	0.0
Interest Exp	0.1	0.1	0.1	0.1	0.1
Associate	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	0.0
PBT	8.6	9.8	8.3	11.6	12.4
Taxation	0.1	1.0	0.8	1.2	1.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	8.5	8.7	7.4	10.5	11.1
Core Net Profit	8.5	8.7	7.4	10.5	11.1

Balance Sheet

FY Dec (RM m)	2010A	2011A	2012E	2013E	2014E
Fixed Assets	7.4	7.7	9.4	10.4	11.5
Intangible Assets	0.4	0.5	0.4	0.4	0.4
Other FA	0.0	0.0	0.0	0.0	0.0
Inventories	1.0	0.3	1.7	1.9	2.0
Receivables	26.3	38.5	42.2	45.8	49.4
Other CA	12.0	26.7	11.9	12.0	12.0
Cash	22.1	25.2	41.5	47.1	52.2
Total Assets	69.2	98.9	107.1	117.5	127.6
Payables	21.9	38.5	36.6	39.7	42.9
ST Borrowings	2.3	1.6	0.0	0.0	0.0
Other ST Liability	3.4	6.6	5.5	6.4	6.6
LT Borrowings	1.2	1.2	1.2	1.2	1.2
Other LT Liability	0.2	0.5	0.4	0.6	0.6
Minorities Int.	0.0	0.0	0.0	0.0	0.0
Net Assets	40.2	50.4	63.4	69.6	76.3
Share Capital	7.5	7.9	16.4	16.4	16.4
Reserves	32.8	42.5	46.9	53.2	59.9
Equity	40.2	50.4	63.4	69.6	76.3

Cashflow Statement

FY Dec (RM m)	2010A	2011A	2012E	2013E	2014E
Operating CF	-3.4	3.9	15.0	12.0	12.0
Investing CF	-1.9	-2.1	-2.0	-2.2	-2.4
Financing CF	-0.6	0.0	-4.6	-4.2	-4.5
Change In Cash	-5.9	1.8	8.4	5.6	5.1
Free CF	-5.3	1.8	12.9	9.8	9.6
CAPEX	1.9	2.1	2.0	2.2	2.4

Source: Kenanga Research

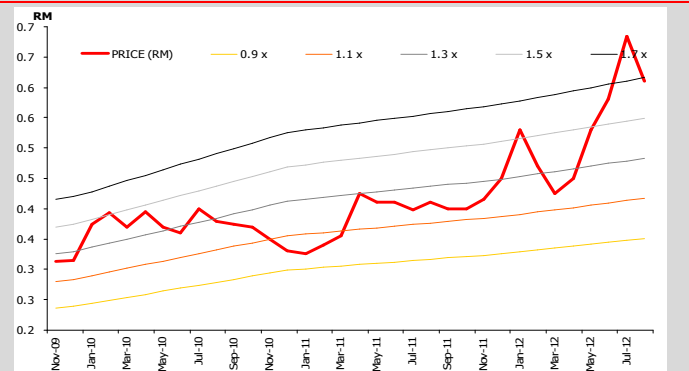
Financial Data & Ratios

FY Dec (RM m)	2010A	2011A	2012E	2013E	2014E
Growth					
Turnover (%)	32.4	65.2	-2.9	8.3	8.0
EBITDA (%)	-0.1	14.4	-14.4	37.0	6.6
Operating Profit (%)	-0.8	13.5	-15.6	40.7	6.5
PBT (%)	-0.8	13.6	-15.5	40.8	6.6
Core Net Profit (%)	5.9	2.1	-14.8	40.8	6.6
Profitability (%)					
EBITDA Margin	11.4	7.9	6.9	8.8	8.7
Operating Margin	10.3	7.1	6.1	8.0	7.9
PBT Margin	10.2	7.0	6.1	7.9	7.8
Core Net Margin	10.1	6.3	5.5	7.1	7.0
Effective Tax Rate	0.6	10.7	10.0	10.0	10.0
ROA	12.3	8.8	6.9	8.9	8.7
ROE	21.2	17.3	11.7	15.0	14.6
DuPont Analysis					
Net Margin (%)	10.1	6.3	5.5	7.1	7.0
Assets Turnover (x)	1.2	1.4	1.3	1.2	1.2
Leverage Factor (x)	1.7	2.0	1.7	1.7	1.7
ROE (%)	21.2	17.3	11.7	15.0	14.6
Leverage					
Debt/Asset (x)	0.1	0.0	0.0	0.0	0.0
Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0
Net Cash/(Debt)	18.6	22.5	40.3	45.9	51.0
Net Debt/Equity (x)	-0.5	-0.4	-0.6	-0.7	-0.7
Valuations					
EPS (sen)	5.4	5.5	4.7	6.6	7.0
GDPS (sen)	1.5	2.0	1.9	2.6	2.8
NTA (RM)	0.3	0.3	0.4	0.4	0.5
PER (x)	9.6	9.4	11.0	7.8	7.4
Gross Div. Yield (%)	2.9	3.9	3.6	5.1	5.4
P/NTA (x)	2.1	1.6	1.3	1.2	1.1
EV/EBITDA (x)	6.6	5.4	4.4	2.8	2.3

Fwd PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

Sector Recommendations***

- OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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